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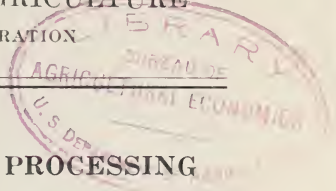
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UNITED STATES DEPARTMENT OF AGRICULTURE

AGRICULTURAL ADJUSTMENT ADMINISTRATION

AAA



AGRICULTURAL PROGRAMS AND THE PROCESSING TAX

Adapted from an address by Lawrence Myers, Chief, Marketing Section, Agricultural Adjustment Administration, delivered in Philadelphia, Pa., April 28, 1938

Current farm programs have their origins in the ineffective demands of the early 1920's. By 1933 the demands for adequate farm relief had become so strong and unified that they necessitated action. Gross agricultural income had declined from nearly 12 billion dollars in 1929 to less than  $5\frac{1}{2}$  billion dollars in 1932. Income available for operators' labor, capital, and management fell from over  $5\frac{1}{2}$  billion dollars to less than  $1\frac{1}{2}$  billion dollars. The gross farm income from cotton and cottonseed had been nearly  $1\frac{1}{2}$  billion dollars in 1928, while in 1931 it amounted to less than  $\frac{1}{2}$  billion dollars. This loss in agricultural purchasing power had serious results for industry. Therefore, when programs for national recovery were being considered, there was general agreement upon the need for extensive relief to agriculture.

The depression of 1920 struck a severe blow at the farm business, especially in the Wheat and Corn Belts. For cotton, the effects of the depression were overshadowed in 1921 and for several years thereafter by the ravages of the boll weevil, which for a time threatened to destroy the cotton growing industry of the United States. For most of the other major agricultural products, however, prices remained comparatively low for several years.

EARLY EFFORTS TO HELP THE FARMER

The first effort to improve the agricultural situation was by increasing tariff rates on agricultural products in the Emergency Tariff Act of 1921. Tariff rates can be effective on commodities which are imported—but they are not effective on commodities which must be exported and sold on world markets. Although the tariffs were effective on some agricultural products, such as wool, they were of little value on others. When the higher agricultural tariffs failed to relieve the agricultural depression, demands arose for programs which would work. Agricultural leaders, accepting the protective principle that higher wages and price levels were needed in the domestic market to support American living standards, turned to programs which were calculated to bring these benefits to agriculture. They refused to accept agricultural tariffs as sufficient.

Out of the farm relief movement of the early 1920's came the tariff equalization fee proposal embodied in the McNary-Haugen bills. The equalization fee, which is identical with the processing tax of the Agricultural Adjustment Act of 1933, provided for the collection

of a fee upon the domestic processing of a commodity. This fee was to be equal to the difference between the actual farm price and the parity price of the commodity. The parity price was a price which would restore the purchasing power of the commodity to its pre-war level. The moneys to be collected from these equalization fees (or processing taxes) were to be used for subsidizing exports. In this manner domestic surpluses were to be sold on world markets at prevailing world prices while prices in the domestic market were to be held at a higher level.

The efforts to get farm relief proposals enacted into law showed that agriculture was not united. The strongest advocates of farm relief were the grain growers. Cotton farmers were not much interested. The cotton problem was how to produce cotton under boll weevil conditions. Short crops had raised cotton prices to far above parity levels. Moreover, the belief grew that an increase in domestic prices for major agricultural products would stimulate domestic production and thereby defeat the program.

To meet the objections that higher prices would cause increased plantings, the domestic allotment plan was developed. Under this plan, payments would be made directly to farmers in accordance with their records of past production. Since farmers would receive only the domestic equivalent of world prices for their crops, and since they could not increase the amount of additional payments by expanding their production, proponents of the domestic allotment plan believed that this proposal would meet the issue.

The 18-million bale cotton crop of 1926 proved that the South had learned to live with the boll weevil. Thereafter, agriculture had a more united interest in farm relief.

Agriculture had been given more ample credit facilities and some basic research and educational programs, including work in cooperative marketing. But the creation of the Federal Farm Board was the first achievement from the demands for direct Federal farm relief. The Federal Farm Board made price pegging loans on agricultural products. The program broke down when deflation got under way after 1929.

Experience during the depression demonstrated certain facts which influenced the agricultural program adopted in 1933. Statistical studies had shown that the consumption of many agricultural products in the United States is not greatly affected by prices. The domestic consumption of wheat flour is relatively stable. Although the consumption of cotton fluctuates widely, the trend of general business is more important than the level of cotton prices. During the depression, United States agricultural surpluses rose to record peaks. The carry-over of American cotton rose from 4½ million bales in 1929 to 13 million bales in 1932 and prices fell from 20 cents per pound to 5 cents per pound. Yet domestic consumption fell from over 7 million bales in 1928-29 to less than 5 million bales in 1931-32. This demonstrated to the cotton farmer that he could not depend upon low prices to stimulate consumption sufficiently to solve the surplus problem.

For these reasons among others, the original Agricultural Adjustment Act placed primary dependence on production control. With funds raised from the processing tax (taken from the equalization fee of the McNary-Haugen plan), benefit payments were to be made

direct to farmers as proposed in the domestic allotment plan. To check production until the surpluses already on hand could be moved into consumption, it was required that farmers reduce their production in order to receive benefit payments.

The idea of reducing agricultural output as a means of solving the agricultural problem was not new. Throughout the decade of the 1920's farmers were frequently told that it was impossible to repeal the law of supply and demand; that farmers themselves were responsible for creating the agricultural surpluses; and that the only effective solution to the problem was for farmers to reduce their production. These arguments reached a peak in the famous suggestion of the Federal Farm Board that cotton farmers plow up every third row. Mere requests, however, failed to recognize that the 6 million American farmers could not carry out a concerted program of production control without Government assistance. Even the largest of the 2 million cotton farmers does not produce enough cotton to have a noticeable effect on prices. The new aspect of the A. A. A. program was that it made the control of agricultural production practical.

#### HOW THE PROCESSING TAX WORKED

It is worth while to examine the processing tax in detail. The rate of the processing tax was 4.2 cents per pound net weight of cotton, or approximately \$20 for a 500-pound gross weight bale. This equaled the difference between the actual price of cotton and the parity price at the time the processing tax was put into effect and it was equal essentially to this difference throughout the period the tax was in effect. Since domestic cotton prices are fixed by the world cotton price level, the processing tax constituted an additional cost on the cotton consumed in the United States.

The higher cost of cotton articles in the domestic market was protected by an equivalent import tax assessed on the importation of manufactured products. In order that this increased cost would not hinder export sales of cotton articles manufactured in the United States, the amount of the tax was refunded upon the exportation of such articles. In that manner the domestic market for cotton goods was protected against bad effects of increased imports or decreased exports as a result of the tax.

When higher prices cause a decrease in the consumption of a commodity, this usually comes about in large part through the use of substitutes for which prices have not increased correspondingly. In the case of the processing tax, an effort was made to guard against the greater use of substitutes by provision for compensatory taxes upon such substitutes when it was found that the cotton processing tax caused an excessive shift from cotton to such other commodities. Under this provision compensatory taxes became effective on various jute and paper products.

A further protective provision permitted the refunding of the tax on low-valued products when it was found that the burden of the tax would substantially reduce consumption. Under this provision the processing tax was refunded on cotton manufactured into large sized bags. While under normal conditions an increase of as much as 4.2 cents per pound on the price of cotton might be expected to reduce domestic consumption by around 400,000 to 500,000 bales

annually, it is apparent that these protective provisions would tend to prevent such result.

An examination of the trend of cotton consumption during the processing tax period in comparison with the trend of industrial production during that period fails to show any appreciable effects of the processing tax upon the level of domestic cotton consumption. (See Chart I.)

For the entire period of the processing tax the index of cotton consumption averaged 91 percent of the 1923-25 average, whereas the index of general industrial production averaged 84 percent, according to the index numbers of the Federal Reserve Board. For the 2 full years that the processing tax was in effect, domestic consumption averaged 5,500,000 bales as compared with an average of 5,400,000 bales for the preceding 3 years.

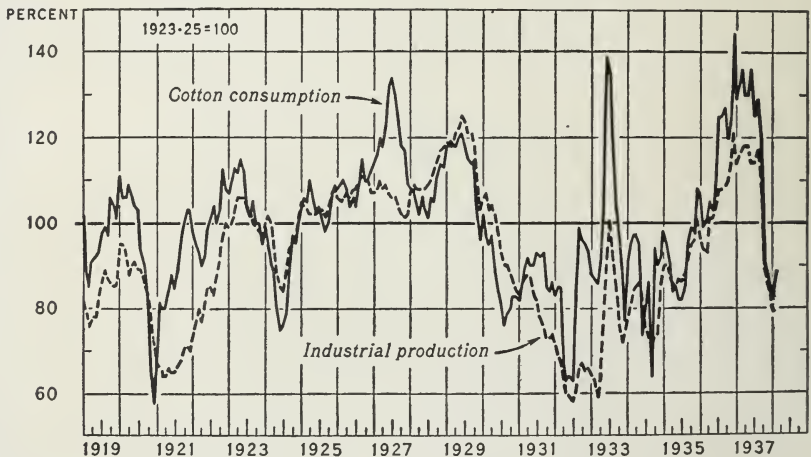


CHART I.—Cotton consumption and industrial production in the United States, 1919-37.

As to the possible effect of the processing tax on wage rates in the cotton textile industry, the facts show clearly that it had none. (See Chart II.)

Wage rates were increased under the Cotton Textile Code, and remained stable until 1936 when exceptionally high profit margins and pressure from organized labor resulted in further increases. The decline which occurred in 1935 in labor costs per pound of cotton consumed was the result of larger output per man-hour.

Mill margins, excluding labor costs and after allowing for the passing on of the full amount of the processing tax, averaged 5.68 cents per pound for 17 constructions during the processing tax period as compared with an average of 5.22 cents for the 3 years before the tax went into effect.

It might be argued that the high mill margins existing in late 1936 and the first part of 1937 show how profitably the industry can operate in the absence of the tax. If so, the decline in late 1937 shows the fallacy of the argument. With greater truth the 1936-37 situation might be cited in refutation of the argument that parity

prices, or processing taxes which bring the total mill cost of cotton up to the parity level, will seriously restrict domestic consumption. During the cotton year 1936-37, mill margins averaged 3.33 cents per

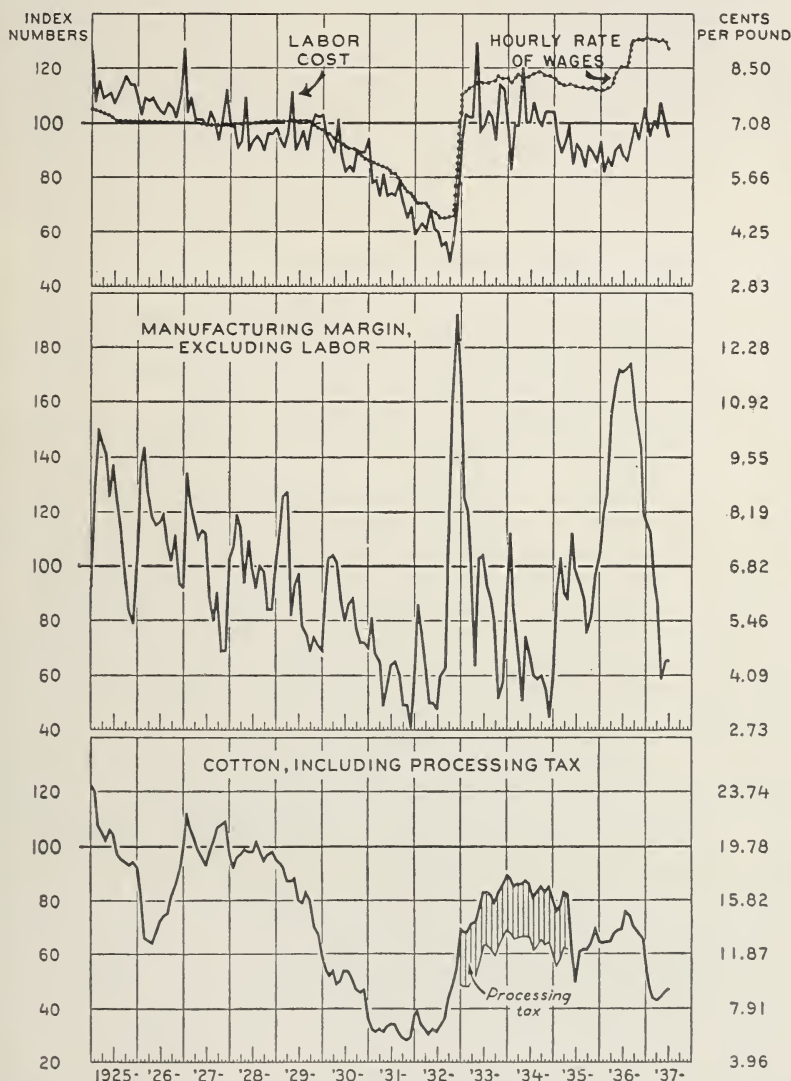


CHART II.—Wage rates and labor costs adjusted for monthly output per man-hour, manufacturing margin excluding labor costs, and cotton costs for 17 constructions of grey cloth from 1925-26 to 1937-38 (years beginning August 1). 1927-28 and 1928-29 average equals 100.

pound above the 1927-29 average and 6.07 cents above the 1931-32 level, yet cotton consumption amounted to 7,950,000 bales. An increase in mill margins obviously places as great a burden on consumers as an equivalent increase in the cost of cotton. The answer

is plain: during a period of rising business activity and inflationary psychology rising prices are not a hindrance to the purchase of cotton goods. On the other hand, when the bubble breaks, falling prices will not induce buying. The cotton textile industry continues to perform in its customary manner, going from one extreme to another.

The reason that the cotton processing tax had little effect on mill margins is evident. The tax was a uniform cost on all cotton consumed in the United States. No one mill could gain a competitive advantage over any other mill by means of the tax. It is doubtful that any other element of cost was so perfectly uniform per pound of cotton consumed as was the processing tax.

### THE PROPOSED "YARN COUNT" PROCESSING TAX

A recent proposal for tariff-equivalent taxes introduced a new suggestion, a tax graduated by yarn counts. This was modeled after the tariff rate structure. In addition to following the pattern of tariff rates, it was believed that such tax, being lower on the coarser yarn counts, would eliminate criticisms that the tax was disproportionately heavy upon coarse goods and articles such as overalls.

It was believed further that the lower rates on coarse counts would avoid any serious competitive problem from low priced substitutes. For rayon, however, a compensatory tax was provided. It is far simpler for Congress to levy taxes in complete detail rather than to require administrative findings before the tax takes effect. No matter how apparent it seems that the increase in rayon consumption has been at the expense of cotton, proof that a processing tax is causing any particular amount of shift is difficult to obtain.

To help examine the two taxes, the rates in the new proposal by yarn counts are compared with the equivalent rates per pound for carded and combed yarn under the former processing tax. (See Chart III.)

While the former cotton processing tax of 4.2 cents per pound was equivalent to 4.7 cents per pound on carded yarn and 5.08 cents per pound on combed yarn of all numbers, the rates under the new proposal begin at 0.5 cent per pound for number 0.1's and increase at the rate of 0.2 cent per pound for each higher yarn number up to and including no. 11's on which the rate is 2.5 cents per pound. Thereafter the rates increase at 0.1 cent per pound per yarn count up to 46's, on which the tax is 6.0 cents per pound. A uniform tax at the rate of 6.0 cents per pound is provided on all counts higher than 46's. The proposed rate on rayon was 6.0 cents per pound for all deniers. The rates in the new proposal are, therefore, lower than the former processing tax on counts under 30's and higher on counts over 40's.

Table 1 gives a comparison in cents per pound of the minimum specific tariff rate, the tariff-equalization fee at the rates in the new proposal, and the former processing tax for various constructions of cotton cloth. For Osnaburg made 50 percent from cotton waste, the former tax was equivalent to 3.78 cents per pound, and under the new proposal the tax would be 1.9 cents per pound, whereas a minimum specific tariff is 4.4 cents per pound. On 80 by 80 carded print cloth, 4 yards weighing 1 pound and made of 33's yarn, the former processing tax was 4.52 cents per pound, the proposed new rate 4.51 cents per pound, and the minimum specific tariff is 18.15

cents per pound. For combed voile made of 50's yarn, the processing tax was 5.22 cents per pound, the new rate would be 6.17 cents per pound, and the minimum specific tariff rate is 27.5 cents per pound. Although the rates for the finer yarn counts are higher under the new proposal than the equivalent of the former processing tax, the average rate under the new proposal for all cotton consumed in the United States would be slightly lower because of the large production of coarse and medium count yarns. Both rates are, as observed, well below the minimum specific tariff rates.

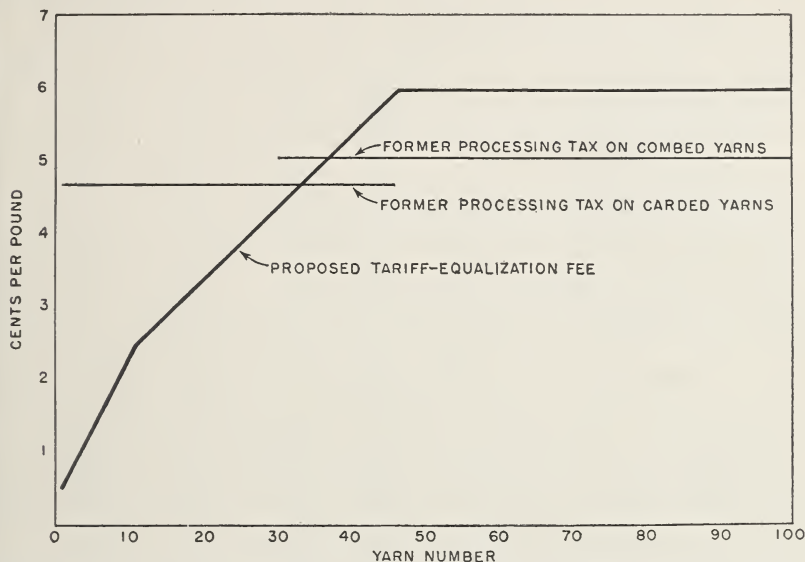


CHART III.—Comparison of the proposed graduated tariff-equalization fee and the former processing tax.

TABLE 1.—*Tariff as compared with processing tax of 4.2 cents per pound net weight of raw cotton and with tariff-equalization fee at rates in the new proposal for specified constructions of cotton goods*

Type	Specifications				Approximate cents per pound of cloth		
	Warp	Filling	Yards per pound	Approximate average count of yarn used	Tariff (minimum specific)	Tariff-equalization fee at rates in the new proposal	Tax at 4.2 cents per pound net weight of raw cotton
Osnaburg—carded.....	40	28	2.05	8	4.40	<sup>1</sup> 1.90	<sup>1</sup> 3.78
Sheeting—carded.....	48	48	2.85	14	7.70	2.76	4.63
Do.....	48	48	4.00	19	10.45	3.25	4.63
Do.....	48	40	5.50	23	12.65	3.64	4.63
Drill—carded.....	66	36	3.95	20	11.00	3.33	4.61
Pocketing twill—carded.....	68	90	2.58	21	11.55	3.43	4.61
Print cloth—carded.....	80	80	4.00	33	18.15	4.51	4.52
Broadcloth—carded.....	100	60	4.10	32	17.60	4.39	4.49
Three leaf twill—carded.....	68	76	4.00	30	16.50	4.31	4.61
Broadcloth—combed.....	128	68	4.40	42	23.10	5.47	4.96
Voile—combed.....	60	56	8.22	50	27.50	6.17	5.22
Lawn—combed.....	76	72	9.00	70	38.50	5.98	5.07

<sup>1</sup> Made in part (50 percent) from cotton waste.

TABLE 2.—*Approximate amount of tariff-equalization fee which would be payable on the quantity of cotton required in the manufacture of specified articles at the rates of tariff-equalization fee in the new proposal and processing tax at the rate of 4.2 cents per pound net weight of raw cotton*

Article	Approximate quantity yarn required	Approximate yarn count	Rates of tariff-equalization fee on yarn count per pound	Cents per article	
				Approximate amount of tariff-equalization fee	Tax at 4.2 cents per pound net weight of raw cotton
Household articles					
Sheets:	Pounds	Number	Cents	Cents	Cents
63 by 99 inches (75 by 68) <sup>1</sup> -----	1.60	23	3.7	5.9	7.5
81 by 90 inches (56 by 46) <sup>2</sup> -----	1.06	23	3.7	3.9	5.0
81 by 99 inches (75 by 68) <sup>1</sup> -----	2.04	23	3.7	7.6	9.6
81 by 99 inches (74 by 62) <sup>1</sup> -----	1.64	23	3.7	6.1	7.7
81 by 99 inches (64 by 64) <sup>2</sup> -----	1.62	23	3.7	6.0	7.6
90 by 108 inches (87 by 80) <sup>1</sup> -----	2.13	26	4.0	8.5	10.0
90 by 108 inches (76 by 68) <sup>1</sup> -----	2.47	23	3.7	9.1	11.6
Pillowcases, pair:					
42 by 36 inches (60 by 48) <sup>2</sup> -----	.36	35	4.9	1.8	1.7
45 by 36 inches (68 by 72) <sup>2</sup> -----	.51	35	4.9	2.5	2.4
45 by 36 inches (80 by 80) <sup>2</sup> -----	.61	35	4.9	3.0	2.9
Muslin, per yard:					
Brown, 36 inches (64 by 68) <sup>2</sup> -----	.28	40	5.4	1.5	1.3
Bleached, 36 inches (73 by 60) <sup>1</sup> -----	.27	40	5.4	1.5	1.4
Bath towels, 24 by 48 inches-----	.68	16	3.0	2.0	3.2
Face towels, 18 by 36 inches-----	.24	12	2.6	.6	1.1
Tablecloths, 54 by 60 inches-----	1.13	17	3.1	3.5	5.3
Napkins, dozen-----	.81	17	3.1	2.5	3.8
Men's clothing					
Overalls-----	1.77	11	2.5	4.4	8.3
Work pants-----	1.32	11	2.5	3.3	6.2
Shirts:					
Chambray work-----	.64	13	2.7	1.7	3.0
Carded broadcloth-----	.60	31	4.5	2.7	2.8
Combed broadcloth-----	.61	40	5.4	3.3	3.1
Pajamas, carded-----	.88	31	4.5	4.0	4.1
Woven athletic union suits-----	.43	31	4.5	1.9	2.0
Woven shorts-----	.24	31	4.5	1.1	1.1
Knit athletic undershirts, carded-----	.17	35	4.9	.8	.8
Socks:					
Carded yarn-----	.09	35	4.9	.4	.4
Mercerized yarn-----	.10	60	6.0	.6	.5
Women's clothing					
House dresses-----	.73	33	4.7	3.4	3.4
Uniforms, carded-----	.72	22	3.6	2.6	3.8
Slips, woven-----	.34	50	6.0	2.0	1.4
Hose:					
Combed yarn-----	.12	70	6.0	.7	.6
Mercerized yarn-----	.14	70	6.0	.8	.7

<sup>1</sup>Warp and filling threads per inch, bleached.

<sup>2</sup>Warp and filling threads per inch, unbleached.

For a further comparison, table 2 shows the amount of the former processing tax and the amount of the proposed new tax for specified cotton articles. For bed sheets the processing tax ranged from 5.0 to 11.6 cents each, while the new rates would range from 3.9 to 9.1 cents. On overalls the former tax equaled 8.3 cents; the proposed tax, 4.4 cents. For knit athletic undershirts made of no. 35 yarn both taxes amount to 0.8 cents per garment. For most items of wearing apparel and household articles the difference between the rates is small and either tax would constitute a comparatively small element in the total cost of the finished article.

## THE DEMAND FOR PROCESSING TAXES

Efforts to obtain processing taxes are likely to recur until the condition of agriculture is improved. Agricultural leaders recognize that agricultural programs will be uncertain until a definite source of funds is available for financing them. But more important, if prices for agricultural products are too low, then the cost of those products can be raised without unfairness or serious injury to consumers in the United States. From the standpoint of the country as a whole, processing taxes, by placing the burden of the program upon the commodity benefited, have a major advantage. In that manner an automatic check is provided upon the demands for governmental assistance. The dangers of vested rights and continued demands for help long after help is necessary, are thereby minimized. When the need for assistance has passed, the American public, whether as taxpayers or as consumers, should be relieved from the burden of supporting such programs.

Excessively high agricultural prices put undue burdens upon consumers and should be avoided, but it can not seriously be argued that agriculture should remain in a depressed condition for the benefit of American consumers. The parity concept appears to be rather generally accepted as a fair goal. The arguments come over the method of achieving that goal. There would be little opposition to achieving parity prices through higher tariff rates if that were possible. Likewise, there should be little objection to moderate production control features of agricultural programs. Production control has certain advantages in dealing with surplus situations and in bringing about reductions in an orderly manner, rather than through the harsh methods of financial liquidation and dispossession. Unfortunately, there are limitations in the extent to which the restriction of output can be used to solve the agricultural problem. American agricultural surpluses are sold in world markets in competition with foreign products. Prices in world markets respond to world production and, if American farmers carry their reduction programs too far, the greatest benefit will go to their foreign competitors. Even price pegging loans bring forth few objections while the money lasts, but they do not get rid of the surplus.

There is universal support for programs to develop new outlets for agricultural products and thereby to increase the demand for them. The Department of Agriculture is engaged in rather extensive efforts in this direction and has numerous projects throughout the United States for trying out cotton in new uses. But the development of new uses does not offer a quick means of eliminating surpluses.

Economic distress and the fear of a peasant agriculture in the United States lead to the proposals for the so-called two-price system to aid agriculture. American agriculture is confident that measures can be devised for giving effective assistance, and is likely to demand such measures until a new stability is achieved.

It may appear to people in industry that these farm problems are far removed from them. The fact that the average cotton farm produced 9 bales of cotton this year which sold for about \$40 per bale, giving \$360 as a gross income to be divided between landlord

and tenant and to pay the cash expenses of production, taxes, interest, and living expenses for a family of 4 to 5 persons for a year, may all seem foreign. The movement of the cotton textile industry and of other industries to the low wage areas of the Cotton Belt, however, is a very close and vital matter to industry. Behind this movement is the low income of cotton farmers. To cotton farmers the low wage rates of southern industry are attractive. So long as the income from cotton production remains low, farm wage rates in the South must remain low, and low-paid farm laborers will continue to press for employment in southern industry. Unless cotton production can be made more profitable, it will be difficult to protect wage rates and manufacturing plants in other parts of the country.



